

2009 IRPAC Public Report Appendix

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Appendix A: Outline of IRPAC's Comments on IRM for U.S. Withholding Agent Examinations

1) Withholding Tax Issues as a Tier I Issue

On Monday, December 8, 2008, IRS Commissioner Doug Shulman announced at the George Washington University International Tax Symposium that the IRS has designated "withholding tax issues" as a Tier I issue. The elevation of withholding tax issues as a Tier I item requires IRS examiners to examine withholding matters during every examination, and to coordinate the audit and their findings with the issue owner executive and issue management team.

IRPAC Comment: The mandatory audit requirement resulting from the Tier I status of withholding tax issues places an undue burden on the IRS and on taxpayers. For many companies, a full-scope withholding tax audit is unnecessary. IRPAC suggests that the Internal Revenue Manual ("IRM") provide that the audit manager has discretion in each case to consider certain predetermined factors (*i.e.*, type of business, industry, internal controls, etc.) with respect to each taxpayer, and, if appropriate, perform a spot check to determine if a full-scope withholding tax audit is required.

2) Comparison of Forms 5471 and 5472 to Forms 1042 and 1042-S

Section 4.10.21.9.6 of the IRM requires IRS examination agents to request copies of Form 5471, *Information Return of United States Persons with Respect to Certain Foreign Corporations*, and Form 5472, *Information Return of a 25% Foreign-Owned Corporation*, to identify payments made to related foreign entities. The examiner is then supposed to match these payments to those reported by the taxpayer on Forms 1042 and 1042-S.

IRPAC Comment: Forms 5471 and 5472 generally are prepared on an accrual basis, whereas fixed or determinable, annual, or periodical payments are reported on a cash disbursements basis. The IRM should note these differences in accounting, and indicate in the Manual that the amounts reported on the Forms 5471 and 5472 may not reconcile with the amounts shown on Forms 1042 and 1042-S.

3) Payments for Personal Services - Contemporaneous Documentation

Generally, personal services are sourced at the location where the services are performed. The burden of proof of non-U.S. source is on the withholding agent. Section 4.10.21.9.4 of the IRM provides the following factors that the IRS examiner should consider in determining where the personal services were performed: contemporaneous records, travel expenses, vendor contracts, and interviews with the approver of the expense or contract.

IRPAC Comment: It should be noted in IRM Section 4.10.21.9.4 that the list of factors to consider is a nonexclusive list, and that the withholding agent can apply a reasonably prudent business person standard to determine where the services were performed. Such factors may include review of contracts, notations on invoices by service provider and/or person who approved the invoice for payment, subsequent confirmations of service performance sent via email or facsimile, among other things.

We also recommend the following portion of subparagraph 2 be deleted " . . . however, keep in mind that they may not be the most reliable source to determine the source of the expense. It is usually in the vendor's best interest to source all income as foreign to minimize the tax withholding." We believe this statement is misleading and could unduly influence an IRS examiner to automatically dismiss the veracity of the service provider's comments. The IRS examiner should consider all available evidence such as any notations on the invoice provided by the vendor along with other related items (e.g., expenses, etc.)

4) Validation Process of Forms W-8

Section 4.10.21.8.4.3 sets forth the steps an examiner should take to determine the validity of Forms W-8.

IRPAC Comment: We recommend the above section be modified to clarify that each section is severable. Specifically, it should state that (1) a Form W-8BEN with an invalid tax treaty claim is still valid to document the beneficial owner's status as foreign (assuming Part I of the form is properly completed) and (2) a Form W-8IMY that is otherwise valid except that one or more of the documentation from the underlying owners is invalid, may still be relied upon by the withholding agent by determining the beneficial owner's status in accordance with the presumption rules contained in Treas. Reg. § 1.1441-5(d)(3).

Appendix B: Supplemental W-4 Instructions for Nonresident Aliens

- Nonresident Aliens must follow special instructions when completing Form W-4. If you are an employee and you receive wages subject to graduated withholding, you will be required to fill out a Form W-4. Also complete Form W-4 for a scholarship or fellowship grant to the extent it represents payment for past, present, or future services. These are services you are required to perform as an employee and as a condition of receiving the scholarship, fellowship or tuition reduction. If you are claiming a tax treaty withholding exemption on this income, do not complete Form W-4. Instead, complete Form 8233, *Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual*. See Form 8233 for more information at www.irs.gov.
- *Are you a Nonresident Alien? If so, these special instructions apply to you.* Keep in mind that terminology and determinations of residency are very different for tax purposes than for immigration purposes. Resident Aliens can include immigrants and nonimmigrants (e.g., foreign students, H-1B visa holders, others). These special Form W-4 instructions do not apply to resident aliens who should follow the general W-4 instructions. A Nonresident Alien:
 - Is, for the most part, temporarily in the U.S. for short periods of time, and does not meet the "substantial presence test" (www.irs.gov/businesses/small/international/article/0,,id=96352,00.html) in this calendar year, and
 - Is not a U.S. citizen or lawful permanent resident (does not hold a "green card" (hyperlink to <http://www.irs.gov/businesses/small/international/article/0,,id=96314,00.html>)).

Individuals become U.S. resident aliens if they are substantially present in the United States under the 183-day residency formula (the "substantial presence test"). You are (or will become) substantially present if you have at least 31 U.S. days in the current calendar year and your U.S. days over the current calendar year and the two prior calendar years will equal or exceed 183 days using this formula: all of the countable U.S. days in the current calendar year, 1/3 of the countable U.S. days in the prior calendar year and 1/6 of the countable U.S. days in the calendar year before the prior calendar year. However, if you reside in Canada or Mexico and commute to work in the United States, your U.S. days might not be countable. If you are in certain U.S. immigration categories, your U.S. days might not count during certain calendar years.

- Foreign-government related individuals in A and G status are always exempt from counting days. (Dependents in A or G status age 21 or older are not exempt from counting days, however.)
- Students, who are in F and M Student status and J Exchange Visitors in the Student category, do not count their U.S. days for 5 calendar years.

- Teachers and Trainees (who include J Exchange Visitors in any of the J Exchange Visitor categories except Students) and Q Cultural Visitors, do not count U.S. days for 2 out of the 7 current calendar years.

Your U.S. days in F, J, M, or Q status in some of the current 3 calendar years might not be exempt-from-counting U.S. days if you were in the U.S. in a prior visit[s] in F, J, M, or Q status. See IRS Publication 519, *U.S. Tax Guide for Aliens* for more information on how to apply the substantial presence test. See also The Green Card Test and the Substantial Presence Test at

www.irs.gov/businesses/small/international/article/0,,id=129390,00.html

Note: If you are a bona fide resident of American Samoa or Puerto Rico for the entire tax year, you generally are taxed the same as a U.S. resident alien. These special instructions do not apply to you; follow the general Form W-4 instructions. For determination as to who are bona fide residents and for information for residents of other U.S. territories or possessions, consult IRS Publication 570, *Tax Guide for Individuals with Income from U.S. Possessions*.

- *What compensation is subject to withholding and requires a W-4?* All wages and any other compensation for services performed by employees in the U.S. are considered to be from sources in the U.S. and are subject to withholding under the graduated income tax withholding tables. Employers need you, a Nonresident Alien, to complete Form W-4 under these special instructions to correctly effect this withholding.
- *Are there any exceptions to this withholding?* Yes, exceptions to withholding are provided for (a) wages paid to employees of foreign employers who earn not more than \$3000 annually and are in the U.S. for not more than 90 days, (b) wages paid to certain crew members, (c) transportation related wages paid to Nonresident Aliens who are residents of Canada or Mexico and (d) certain wages paid to Nonresident Aliens who are residents of Puerto Rico, or the U.S. Virgin Islands. See IRS Publication 519 to see if you qualify for these exceptions.
- *Treaty Exceptions.* If you perform personal services as an employee or as an independent contractor and you can claim an exemption from withholding on that personal service income because of a tax treaty, give Form 8233 to each withholding agent from whom amounts will be received. Even if you submit Form 8233, the withholding agent may have to withhold tax from your income. This is because the factors on which the treaty exemption is based may not be determinable until after the close of the tax year. In these cases, you must file Form 1040NR (or Form 1040NR-EZ if you qualify) to recover any overwithheld tax and to provide the IRS with proof that you are entitled to the treaty exemption. See IRS Form 8233 and related instructions, as well as IRS Publications 519 and 550 for further information on treaty benefits.

- *Am I required to file a U.S. tax return even if I am a Nonresident Alien?* Yes. Nonresident Aliens who receive U.S. sourced compensation are required to file U.S. tax returns on Form 1040NR and pay U.S. taxes on their U.S. sourced compensation. However, if your only U.S. source income is wages, and your total annual wages do not exceed the Personal Exemption Amount, then you are not required to file a U.S. tax return. Employers are required to withhold income taxes from your pay under special rules and in order to do so, employers will ask you to complete IRS Form W-4 under these special instructions. Any withheld amounts are credits against your U.S. tax return when you file.
- *Will my withholding amounts be different from withholding for my U.S. co-workers?* Yes. As a Nonresident Alien, you cannot claim the standard deduction amount when you file your U.S. Form 1040NR. In addition, Nonresident Aliens do not qualify for the Making Work Pay Credit made available in 2009 and 2010 under the American Recovery and Reinvestment Act. The Making Work Pay Credit is a refundable tax credit of up to \$400 for working individuals (and \$800 for married taxpayers filing joint returns) who are U.S. citizens and tax residents. The benefits of the standard deduction and the Making Work Pay Credit are included in the existing wage withholding tables published in IRS Publication 15 T. Since Nonresident Aliens do not qualify for these benefits, employers are instructed to withhold an additional amount from a Nonresident Alien's wages. For more information, see Notice 2005-76 on page 947 of Internal Revenue Bulletin 2005-46 at www.irs.gov/pub/irs-irbs/irb05-46.pdf. For the specific amounts to be added to wages before application of the wage tables, see IRS Publication 15T. Nonresident Aliens students from India and business apprentices from India are not subject to this procedure.
- Cites to IRS publications for additional information. Publications 15, 515, 519, 550 and 570.

SPECIAL FORM W-4 INSTRUCTIONS FOR NONRESIDENT ALIENS

- *What are the special Form W-4 instructions?* Nonresident Aliens required to complete Form W-4 must follow these instructions:
 - Line 3: Check "single" regardless of your actual marital status.
 - Line 5: Claim only one withholding allowance unless you are:
 - A resident of Canada, Mexico, or the Republic of Korea (South Korea) who meet tax treaty terms in the relevant United States tax treaties allowing more than one personal allowance,
 - A U.S. National,

Note: A U.S. National is an individual who, although not a U.S. citizen, owes his or her allegiance to the United States. U.S. nationals include American Samoans and Northern Mariana Islanders who chose to become U.S. Nationals instead of U.S. citizens.

- Or, a resident from India who entered as a student or business apprentice who is allowed more than one personal allowance under the United States-India Income Tax Treaty.

Line 6: Write “Nonresident Alien” or “NRA” above the dotted line. Optional – enter any additional amount you want withheld from each paycheck. A Nonresident Alien employee may request additional withholding at his or her option for other purposes.

Line 7: Do not make any entry. You are not allowed to claim exemption from withholding.

- *Scholarships and Fellowship grants paid for services:* Any part of a scholarship or fellowship grant that is a payment for services past, present, or future is subject to graduated withholding as wages, and requires Form W-4 completion under the instructions above.

Appendix C: Form 5500 Enhancements

APPENDIX F, SCHEDULE 10

Late Form 5500-EZ Filers

Plan Name: _____ EIN: _____ Plan #: _____

PART I. YEAR(S) OF FAILURE (check one)

- ☐ Late Form 5500-EZ for years: _____ [list late years]
- ☐ Late Form 5500 (only for plans without employees as described in 29 CFR § 2510.3-3(b) and (c)) for years: _____ [list late years]

PART II. LATE FILINGS (check one)

- ☐ Attach for each year noted in Part I above, the most current Form 5500 Series Annual Return/Report form prepared (including all schedules and attachments) and indicate in the appropriate space on the first page of the Form 5500 the plan year for which the annual return/report is being filed.
- ☐ Attach for each year noted in Part I above, the Form 5500 Series Annual Return/Report form prepared for such plan year (including all schedules and attachments).

PART III. CONFIRMATION OF ELECTRONIC SUBMISSION

- ☐ Check this box to confirm that a copy of the late filings was transmitted to the Service at the appropriate ERISA Filing Acceptance System (EFAST) address listed in the instructions for the most current Form 5500 Annual Return/Report, or electronically in accordance with the EFAST electronic filing requirements. Mark Box B and attach a statement that the report is being submitted under the EPCRS Program with "**Form 5500, Box B - EPCRS FILING**" prominently displayed at the top of the statement.

Appendix D: Specific Comments to Form 945-X and Instructions

I. Form 945-X

The form is brief, visually intuitive and plain English, but needs some clarification and emphasis.

1. Under the name and address, the flush language should be clear to state that the only errors to be used with this form are administrative. The word “administrative” can be used preceding the word “error” in the first sentence.
2. Since the form tells the preparer to complete both pages of the form in two places, it may be more helpful to delete that reference in the bold text underneath the name and address on the first page and instead leave the second sentence as a centered page item to bring more attention to it in bold. We also suggest that the sentence be altered to read: It is important to understand the definitions for the terms used in this form. It is imperative that you read the instructions before you complete this form to avoid later corrections and communications by IRS personnel and delayed processing.

II. Instructions for Form 945-X

Our comments are structured to follow the instruction format for ease of attribution to the specific instruction. One result the Committee would like to see is more concise and less repetitive information in order to decrease the length of the instructions, where possible.

What's New?

1. Second Paragraph. We recommend that this paragraph/sentence be deleted from this section as it is better placed as the last sentence of the first paragraph under **Specific Instructions: Part 1: Select ONLY One Process.**
2. Third Paragraph - Since Form 945-X requests the preparer to read the instructions before completing the form, paragraph three should be deleted in its entirety, as its content is communicated either in the form itself or elsewhere throughout the instructions
3. Fourth Paragraph. **Background** paragraph should be removed from this section and only its first sentence placed as the first sentence of the **New Form** paragraph because this content is stated in other parts of the instructions.
4. Fifth Paragraph. This paragraph should be removed from this section and moved to the third paragraph of the section **What is the Purpose of Form 945-X?**
5. Sixth Paragraph. We recommend that this paragraph be deleted in its entirety as its contents are already contained in the Paperwork Reduction Act Notice and also in the section: **Where Can you Get Help?**
6. Eighth Paragraph. We believe Form 945-X will be a useful form but its use to essentially replace Line 3 of Form 945 should be explained in the first paragraph of the instructions. The 945 should also be made clear this is to be used for an administrative mistake – just like we believe the instructions should make clear what comprises an administrative error.

General Instructions: Understanding Form 945-X

1. What is the Purpose of Form 945-X? The first sentence should be rewritten:
“Use Form 945-X to correct an administrative error on a previously filed Form 945. DO NOT file a new Form 945; file Form 945-X by itself to correct the error. Use Form 945-X to correct the reporting of either federal income taxes withheld from pensions, annuities, IRAs, gambling winnings, etc., or backup withholding from interest, dividends, broker transactions, contractor payments, prizes and awards, etc. The instructions that refer to “federal income taxes” apply equally to the correction of backup withholding administrative errors.”
2. The last sentence of the third paragraph under **Part 2 What Amounts Should You Report in Part 2** should be deleted from that paragraph and placed as the last paragraph of this section.
3. Where to get Help? This paragraph should be deleted as its contents are in the instructions in the **Paperwork Reduction Act** section and also **How Can You Order Forms and Publications from the IRS?** Section.
4. When Should You file Form 945-X? The first line should include “administrative” as preceding the term “error” in the first sentence. This section should refer to a definitions section and be used to provide examples for each type of potential use: gambling, backup and retirement plan distributions.
5. **Due Dates.** The last three sentences should be deleted as redundant in the effort to shorten the length of the instructions.